Office Supreme Court, U.S.
FILED
FEB 14 1963
JOHN F. DAVIS, CLERK

In the Supreme Court

of the United States

OCTOBER TERM, 1962

No. 828

HENRY A. KUCKENBERG, Transferee,
HARRIET KUCKENBERG, Transferee,
LAWRENCE W. KUCKENBERG, Transferee,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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SUBJECT INDEX

	Page
Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit	1
Citations to Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes Involved	3
Statement of Case	3
Transferee Issue	3
Sale of Construction Contracts under IRC § 337 Issue	4
Reasons for Granting the Writ	6
Transferee Issue	6
Sale of Construction Contracts IRC § 337 Issue	7
Conclusion	8
Appendix A	9
Appendix B	12

CASE

Commissioner v. Stern, 357 U.S. 39, 78 S. Ct. 1047 (1958) 2, 6

STATUTES

28 U.S.C. Sec. 337 (Sec. 337 of Internal Revenue Code of 1954) 2, 3, 5, 7, 8

28 U.S.C. Sec. 446 (Sec. 446 of Internal Revenue Code of 1954) 3, 5, 7, 8

28 U.S.C. Sec. 6212 (Sec. 6212 of Internal Revenue Code of 1954) 4, 7

28 U.S.C. Sec. 6213 (Sec. 6213 of Internal Revenue Code of 1954) 4

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Petitioners pray that a writ of certiorari issue to review the judgments of the United States Court of Appeals for the Ninth Circuit entered on October 11, 1962, in the above-entitled cases, consolidated herein, with the denial of petitions for rehearing on November 16, 1962.

CITATIONS TO OPINIONS BELOW

The findings of fact and opinion of the Tax Court of the United States are printed (R. 152-187) and are re-

ported in 29 TC 339. The opinion of the Court of Appeals, printed in Appendix B, infra, page 12, is reported in 309 F.2d 202 (1962).

JURISDICTION

The judgment of the Court of Appeals was entered October 11, 1962, (R. 274). Rehearing was denied on November 16, 1962, (R. 275). The jurisdiction of this court is invoked under 28 USC § 1254(1).

QUESTIONS PRESENTED

1. Are petitioners liable as transferees under the doctrine of *Commissioner* v. *Stern*, 357 U.S. 39, 78 S. Ct. 1047 (1958), for income tax deficiencies asserted by the Commissioner of Internal Revenue against Kuckenberg Construction Co. when:

(a) Neither the Tax Court nor the Court of Appeals could refer to any Oregon statutory or case law to support transferee liability in the instant situation; and

(b) The Tax Court and Court of Appeals disregarded the Oregon cases cited by petitioners, the clear import of which cases negates the imposition of transferee liability unless the alleged claim has been perfected into an obligation due and payable at some stage of some proceeding against the transferor?

2. Is a liquidating corporation entitled to the benefits of § 337 (a) of the Internal Revenue Code of 1954, upon the sale of three construction contracts when the corpo-

ration complied with all the statutory prerequisites under said section, or may the Commissioner employ the provisions of § 446(b) of the Internal Revenue Code of 1954 to defeat the benefits specifically bestowed by IRC § 337(a)?

STATUTES INVOLVED

The Federal statutes involved are:

Internal Revenue Code of 1954, Section 337; Section 446; Section 6212; Section 6213.
26 U.S.C. Sections 337, 446, 6212 and 6213.

The applicable portions of these statutes are printed in Appendix A, infra, page 9.

STATEMENT OF CASE

This proceeding involves the Federal income tax liability of petitioners as transferees for alleged income tax deficiencies of Kuckenberg Construction Co., a dissolved Oregon corporation, for the calendar year 1954 and the period January 1, 1955 to December 7, 1955.

Transferee Issue

The Commissioner of Internal Revenue assessed the deficiencies in question against the petitioners on April 24, 1958 (R. 22, 34, 42, 155-156). The petitioners promptly filed petitions with the Tax Court of the United States denying transferee liability and requesting a redetermination of the asserted deficiencies of Kuckenberg Construction Co. in the event transferee li-

ability should be sustained (R. 3, 8, 18-22). The deficiencies sought to be enforced by the Commissioner against the petitioners as transferees have never been asserted against the corporation, and the Commissioner has made no levy or demand upon the corporation in respect of the deficiencies. No statutory notice has been issued by the Commissioner to the corporation under IRC § 6212 (R. 59). Hence, the statutory bar of IRC § 6213 (a) precludes the Commissioner from becoming any type of creditor of the corporation. Following a trial upon the issues before the Tax Court of the United States, the Tax Court held that the petitioners were liable as transferees for any income tax deficiencies of the corporation. The petitioners filed a petition for review of the decision of the Tax Court before the United States Court of Appeals for the Ninth Circuit, which affirmed the Tax Court's decision imposing transferee liability upon the petitioners. The petitioners' timely petitions for rehearing were denied without opinion. Neither Court could cite any Oregon law for upholding this decision and both courts ignored petitioners' reference to the applicable Oregon cases, the clear import of which cases requires that the claimant perfect his claim into an obligation due and payable at some stage of some proceeding against the transferor.

Sale of Construction Contracts under IRC § 337 Issue

The corporation was a cash-basis taxpayer and filed Federal income tax returns on that basis. Pursuant to a plan of complete liquidation, adopted on December 17, 1954, the corporation sold, transferred and assigned

three construction contracts to a third party in an arm's-length transaction for the total purchase price of $327,000.

The Commissioner has stipulated that the corporation sold, transferred and assigned the three construction contracts to a third party and the amounts received by the corporation constituted the consideration for the sale, transfer and assignment of the three construction contracts (R. 48 Stip. para. 13).

The Tax Court found, as a matter of fact, that the contracts constituted property, gains from the sale of which fell within the nonrecognition provisions of IRC § 337(a) and that the exclusionary provisions of IRC § 337(b) did not apply (R. 153, 178).

The Tax Court held in favor of the Kuckenbergs and, contrary to the assertions of the Commissioner, decided that realization of the income upon the sale of the contracts constituted a realization of income upon the sale of property within the nonrecognition provisions of IRC § 337(a).

The United States Court of Appeals for the Ninth Circuit reversed the Tax Court on this issue and held for the Commissioner. The Court did not deny that the construction contracts constituted property within the meaning of IRC § 337(a), but held that the Commissioner was entitled to invoke the provisions of IRC § 446(b) to deny to the corporation the benefits specifically bestowed by IRC § 337(a).

REASONS FOR GRANTING THE WRIT

Transferee Issue:

It is respectfully submitted that the United States Court of Appeals for the Ninth Circuit and the Tax Court of the United States preceding have failed to follow the mandate of this Court in *Commissioner* v. *Stern*, 357 U.S. 39, 78 S. Ct. 1047 (1958), by imposing substantive transferee liability under circumstances contrary to Oregon law. The direction of this Court, as expressed in *Stern*, requires that in order for the Commissioner to assess the federal income tax liability of the transferor against the transferee, all steps required under state law must be taken which give rise to the imposition of substantive transferee liability. Such failure to follow the mandate of *Stern* is evidenced by the following:

(i) Neither court cites any Oregon law in support of its position; and

(ii) Both courts refused to refute the Oregon cases cited by petitioners. The clear import of the Oregon cases requires that there can be no transferee liability until the claimant perfects his alleged claim into an obligation due and payable at some stage of some proceeding against the transferor.

By "some stage" petitioners do not contend that the claimant must obtain *prior* judgment against the transferor or fulfill any other prerequisites of the exhaustion of remedies doctrine and the various ramifications emanating therefrom.

By "some proceedings" petitioners recognize that the Oregon substantive deficiency could have been remedied by the application of federal procedures, i.e., issuance of statutory notice to Kuckenberg Construction Co. under IRC § 6212.

Petitioners simply contend that, in Oregon, transferee liability may be imposed only upon perfection of the claim as a definite obligation of the transferor.

Just as taxpayers are required to turn square corners in dealing with the government, the government is required to turn square corners when dealing with transferees. It seems quite evident that the Commissioner rounded the corner in the instant procedings.

Sale of Construction Contracts IRC § 337. Issue

The petitioners respectfully submit that for the first time in the history of IRC § 337 a Court of the United States has denied to a liquidating corporation the benefits bestowed by the unequivocal language of IRC § 337.

The Tax Court found that the corporation met all of the prerequisites of the statutory requirements under IRC § 337. The Court of Appeals does not deny the applicability of IRC § 337, but that Court held that all of the benefits of IRC § 337 were nullified by application of the provisions of IRC § 446(b).

Where realized income or gain is clearly reflected under the accounting method employed by the taxpayer, and where the income so reflected results in favorable tax consequences under a nonrecognition provision of the code invoked by the taxpayer, the Commissioner cannot,

through a change of a taxpayer's accounting method, avoid the impact of a nonrecognition provision. At least, any such ability of the Commissioner is beyond the scope of IRC § 446 (b).

IRC § 337 specifically provides for nonrecognition of gain to liquidating corporations upon the sale or exchange of property. The petitioners respectfully request this Court to restore to taxpayers the benefits of the express unequivocal language of IRC § 337.

CONCLUSION

For the foregoing reasons, this petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX A

I

Internal Revenue Code of 1954—Provisions Pertinent to Transferee Issue:

SEC. 6212. NOTICE OF DEFICIENCY.

(a) IN GENERAL.—If the Secretary or his delegate determines that there is a deficiency in respect to any tax imposed by subtitles A or B, he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail.

SEC. 6213. RESTRICTIONS APPLICABLE TO DEFICIENCIES; PETITION TO TAX COURT.

(a) TIME FOR FILING PETITION AND RESTRICTION ON ASSESSMENT.—Within 90 days, * * * after the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. Except as otherwise provided in Section 6861 no assessment of a deficiency in respect of any tax imposed by subtitle A or B and no levy or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, or until the expiration of such 90-day or 150-day period, as the case may be, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final.

II

Internal Revenue Code of 1954—Provisions Pertinent to Sale of Construction Contracts under IRC § 337 Issue:

SEC. 337. GAIN OR LOSS ON SALES OR EX-

CHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

(a) GENERAL RULE.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) PROPERTY DEFINED.—

(1) IN GENERAL.—For purposes of subsection (a), the term "property" does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) NONRECOGNITION WITH RESPECT TO INVENTORY IN CERTAIN CASES. — Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with

this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale of exchange.

* * * * *

SEC. 446. GENERAL RULE FOR METHODS OF ACCOUNTING.

(a) GENERAL RULE.—Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

(b) EXCEPTIONS.—If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income.

* * * * *

APPENDIX B

Opinion of United States Court of Appeals for the Ninth Circuit, MERRILL, Circuit Judge:

Kuckenberg Construction Company, an Oregon corporation, pursuant to a plan of complete liquidation sold and assigned three construction contracts, the income from which had been fully earned, to an independent purchaser for $327,000.00. The company was on the cash method of accounting. The question presented by this review is whether, under § 337(a) of the Internal Revenue Code of 1954,[1] nonrecognition attached to the proceeds of this sale. The tax court held for the taxpayers and the commissioner has petitioned this court for review. We here hold that the proceeds are taxable.

Respondents are the transferees of the assets of Kuckenberg Construction Company. A second question is presented by their contention that they may not, as transferees, be held liable for tax payable by the transferor corporation. We here hold that they are liable.

Upon dissolution of the corporation, the transferees continued the construction business in partnership form. Among the corporate assets was an uncompleted contract known as the "Booth Ranch Contract," which was

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[1] "General Rule—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period."

transferred to respondents for completion. In his notices of transferee liability, the commissioner determined that in order to clearly reflect the corporate income the profits from the Booth Ranch Contract should be allocated between the corporation and the partnership in accordance with the percentage of completion method of computation. The tax court upheld the commissioner in this determination and the transferees have petitioned this court for review. Upon this question we here affirm the ruling of the tax court.

The record discloses the following facts:

From its incorporation under the laws of Oregon on December 6, 1949, until January 14, 1955, the Kuckenberg Construction Company was engaged in the heavy construction business, consisting primarily of road building and related work. During the periods here involved, the corporation maintained its principal office and place of business in Portland, Oregon. Respondents were the officers and directors of the corporation, and at all pertinent times the outstanding capital stock of the corporation consisted of shares of common stock all of which were owned by respondents.

The corporation employed the cash basis method of accounting and its federal tax returns were filed on this basis.

On December 17, 1954, the board of directors of the corporation adopted and the stockholders approved a plan of complete liquidation of the corporation. The corporation then executed and duly filed with the Corpo-

ration Commissioner of Oregon a statement of intent to dissolve pursuant to the provisions of Oregon law.

On December 27, 1954, pursuant to the plan of complete liquidation, the corporation sold and assigned three construction contracts to one Simpson for $327,000.00, payable in installments.

Simpson was not in the construction business, but was a real estate agent and operator. The construction company had completed the work it was required to perform in connection with these contracts, but settlement had not been made at the time its board of directors decided to dissolve the corporation. In the sale and transfer of the contracts the corporation warranted that the purchaser would receive substantial specified sums in excess of any expenditures which he might have to make under the contract. The corporation also indemnified the purchaser from any liability resulting from the contract and the activities of the corporation thereunder prior to the sale and transfer. In the agreements of assignment with respect to the contract, the corporation guaranteed that each contract "has been or will be fully performed in accordance with its terms." By agreement respondent Henry A. Kuckenberg warranted that the purchaser Simpson would receive at least $327,000.00 from the three contracts in excess of any expenditures by the purchaser under those contracts, and agreed that upon demand Mr. Kuckenberg would pay any deficit existing on October 1, 1955.

On January 25, 1955, the liquidation of the corporation was accomplished. Liquidating distributions were

made to respondents and left the corporation without any assets after December 7, 1955. On that date the corporation filed articles of dissolution with the Oregon corporation commissioner pursuant to Oregon law, and on the same date the corporation commissioner issued his certificate of dissolution.

On April 25, 1958, notices of deficiency in the income taxes of Kuckenberg Construction Company for the taxable years 1954 and January 1, 1955, to December 7, 1955, were issued to respondents as transferees of the assets of the corporation. The notices of deficiency and attached exhibits stated that the corporation had been dissolved and liquidated and that its assets had been transferred to respondents during 1955 and that no notice of deficiency was issued to the corporation.

Respondents' position, which was accepted by the tax court, is that the sums realized from the assignment of the contracts constituted "gain from the sale of property" under § 337(a) and consequently are not to be recognized for tax purposes.

The commissioner, on the other hand, asserts that had the corporation been on the accrual method of accounting the income from these contracts would have become taxable when earned; that it is only the fact that the corporation was on the cash basis which has made it possible for this earned income to be transformed into what appears to be a gain from sale; that the cash method of accounting under these circumstances does not clearly reflect income, and that the commissioner was therefore within his authority under § 446(b) of the

Internal Revenue Code[2] in requiring a computation by a method which would clearly reflect income.[3]

We agree with the commissioner.

In *Floyd v. Scofield*, 5 Cir., 1952, 193 F.2d 594, the court dealt with a liquidation of a cash basis corporation in which accounts receivable were distributed to the shareholders. In holding the corporation taxable the court stated (at pages 595-596):

> "The question here, as in *Helvering v. Horst*, 311 U.S. 112, 61 S.Ct. 144, 146, 85 L.Ed. 75, is whether one who is presently entitled to receive income, and who is taxable only on receipt of payment, can escape taxation by giving away his right thereto in advance of actual payment. * * *
>
> "To hold that the corporation is not liable in these circumstances would enable it to escape taxation by the simple device of dissolving prior to actual collection by it of monies fully earned by and payable to the corporation *before* liquidation. * * *
>
> "The method of accounting employed by the corporation with respect to this transaction does not clearly reflect the corporate income. The Commissioner was well within his authority under Sec. 311, Int. Rev. Code, 26 U.S.C.A. § 311, in reappraising the situation and requiring a computation by a method which clearly and accurately reflects the income in question."

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[2] "Exceptions.—If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate does clearly reflect income."

[3] The deficiency notice to these taxpayers states:
"It is determined, because of the liquidation of Kuckenberg Construction Co., that there should be taxed to the corporation, in its last taxable periods, earnings of $359,446.42 on three certain construction contracts under the provisions of section 446(b) of the Internal Revenue Code of 1954."

In *United States* v. *Lynch*, 9 Cir., 1951, 192 F.2d 718, 721, this court stated:

> "We understand appellant to contend that the income in question is not that of the corporation. The answer is, that the corporation has performed the services which create the right to the income which brings into play the basic rule that income shall be taxed to him who earns it. *Helvering* v. *Eubank*, 1940, 311 U.S. 122, 61 S.Ct. 149, 85 L.Ed. 81. A corporate liquidation and transfer of assets cannot divert taxability of income already earned any more than does an assignment of such income."

In *Williamson* v. *United States*, Ct.Cl., 1961, 292 F.2d 524, where the court, under similar circumstances, followed *Floyd* v. *Scofield*, supra, it was stated at page 530:

> "In any case the outcome hinges upon whether there had been a realization of income by the distributing corporation. It is fundamental that all economic gain is not taxable income and that it is the realization of income that is the taxable event. But the law contemplates that there is some point at which all income which has accrued, in the sense of having been fully earned, will be realized and taxable to him who earned it regardless of the accounting method involved. An acceptable accounting method should simply indicate this point logically and consistently."[4]

Respondents protest that these were cases of distribution of assets to shareholders under §§ 311 or 336; that the case at bar is one of a sale by a liquidating corporation clearly falling within § 337(a); that to sanction the commissioner's authority to change the method of

[4] These principles have also been recognized by this court in Idaho First National Bank vs. United States, 9 Cir., 1959, 265 F.2d 6.

accounting under these circumstances is to deprive respondents of a right clearly and expressly bestowed by § 337(a).

We cannot agree. The purpose of § 337(a) was to eliminate the formal problem created by *Commissioner of Internal Revenue* v. *Court Holding Co.*, 1945, 324 U.S. 331, and *United States* v. *Cumberland Public Service Co.*, 1950, 338 U.S. 451, by achieving uniformity of tax treatment for the sale of assets by a liquidating corporation and the sale of assets by shareholders to whom the assets had been distributed in liquidation.[5] Section 337 was thus intended to erase a formalistic inequity and not to create one. We find no suggestion or intimation that it was ever contemplated that a cash basis taxpayer was to receive unequal and advantageous treatment over an accrual basis taxpayer through his ability to avoid the consequences of an anticipatory assignment of earned income.

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[5] The Senate report relating to § 337 states:
"Section 337 * * * concerns the problems raised by the decisions in Commissioner v. Court Holding Co. * * * and United States v. Cumberland Public Service Co. * * * and the numerous related cases. These decisions involve the question of whether the corporation or the shareholder effected a sale of property in connection with the liquidation of the corporation. Under the decision in Cumberland Public Service Co., supra, it is indicated that in the case of a distribution of property in liquidation of a corporation followed by its sale made in fact by its shareholders, a single tax is imposed at the shareholder level. Where the shareholders in fact did not effect the sale tax is imposed both at the corporate and at the shareholder level. Accordingly, under present law the tax consequences arising from sales made in the course of liquidations may depend primarily upon the formal manner in which the transactions are arranged. Your committee intends in section 337 to provide a definite rule which will eliminate the present uncertainties." S. Rep. No. 1622, 83d Cong., 2d Sess., p. 258.

We conclude that the commissioner was within his authority in computing income by the method selected; that the proceeds of the assignment of these construction contracts constituted recognized income to the liquidating corporation.

Respondents contend, for three reasons, that even accepting corporate liability for the tax in question, they may not be held liable as transferees of the corporation's assets under § 6201 of the Internal Revenue Code.

First they assert that the United States does not have the status of a creditor since no ninety-day letter was sent to the corporation. However, the government need not take futile assessment against a taxpayer without assets, *Ginsberg* v. *Commissioner of Internal Revenue*, 2 Cir., 1962, 305 F.2d 664; *Flynn* v. *Commissioner of Internal Revenue*, 5 Cir., 1935, 77 F.2d 180.

With respect to the procedural requirement of notice of deficiency, H. Conference Rep. No. 356 (1939-1 Cum. Bull., Part 2, 361, 372) states the intention of Congress very explicitly as follows:

> "Section 274(a) [predecessor of Sections 6212 and 6213 of the 1954 Code] requires notice of a deficiency in a tax to be sent the taxpayer before further proceedings for collection of the tax liability are continued. The section, however, in terms applies only to a deficiency in a tax and does not apply to the liability of a transferee in respect of the tax of the taxpayer. Therefore, in proceedings against the transferee, notice need not be given the taxpayer under section 274(a). However, under the substitute agreed to by the conferees, the liability of the transferee is collected in the same manner as the liability for tax. Section 274(a) is

thus incorporated by a reference, but the result of such reference is that for procedural purposes the transferee is treated as a taxpayer would be treated, and under section 274(a) notice would be sent to the transferee (and not the taxpayer) in proceedings to enforce the liability of the transferee."

Next, respondents assert that the United States, by failing to comply with the provisions of Oregon law, has failed to perfect its right to proceed against transferees. Specifically, it is asserted that Oregon requires the creditor to proceed to judgment and a return of execution nulla bona.

It is necessary, under *Commissioner* v. *Stern*, 1958, 357 U.S. 39, to look to state law in order to determine the transferee's substantive liability. However, the court in *Stern* assumed as a matter of course that the transferee provisions of the Internal Revenue Code governed the procedure the commissioner had to follow in asserting and enforcing that liability. The United States, in seeking to collect federal taxes, was not expected by Congress to follow the procedural intricacies of every one of the fifty states.[6] Oregon law here provides, when

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[6] See Ginsberg v. Commissioner of Internal Revenue, 2 Cir., 1962, 305 F.2d 664.

The legislative history of the transferee liability provisions of the Code shows that they were designed to facilitate proceedings against transferees in the same manner as against a taxpayer and to eliminate the need for previous cumbersome procedures. The pertinent legislative history concerns § 280, Revenue Act of 1926, c. 27, 44 Stat. 9, from which § 311 of the 1939 Code (discussed in Commissioner vs. Stern, supra) and § 6901 of the 1954 Code, here in issue, were derived. Provisions with respect to the limitation of the period for assessment against a transferee were added initially in § 311(b) of the Revenue Act of 1928, c. 852, 45 Stat. 791. No pertinent changes from prior law were made in § 6901 of the 1954 Code. H. Rep. No. 1337, 83d Cong., 2d Sess., pp. A422-A423; S. Rep. No. 1622, 83d Cong., 2d Sess., p. 599.

proper steps are taken, that these transferees shall be liable. That suffices.

Third, respondents contend that to assert transferee liability the government must reach the trust fund; that the transferees put the money in a partnership which, under Oregon law, is a separate entity. Therefore, the government should have proceeded against the partnership rather than the partners.

We feel there is no merit to this contention. Respondents were the recipients and, as partners, are still in ownership and control.

We conclude that respondents, as transferees, are liable for the unpaid tax of the corporation.

Respondents have petitioned for review of the tax court's decision upholding the commissioner in his determination that tax was due from the corporation on the "Booth Ranch contract." This contract, uncompleted by the corporation, was assigned to taxpayers and profitably completed by them. At the time of assignment the corporation had incurred a substantial portion of the total expense of the contract and had performed substantial work on it. On its cash basis the corporation had reported a loss.

The commissioner determined that the cash method did not clearly reflect income and, under § 446(b), applied the percentage of completion method, by which he determined income to the corporation in 1955 from the Booth Ranch contract of $6,566.63. He was upheld by the tax court.

Respondents concede that the commissioner has authority under § 446(b) in proper cases to change a taxpayer's accounting methods from completed contract to percentage of completion. *Jud Plumbing & Heating* v. *Commissioner*, 5 Cir., 1946, 153 F.2d 681; *Standard Paving Co.* v. *Commissioner*, 10 Cir., 1951, 190 F.2d 330. They contend, however, that such a change cannot be based solely on hindsight but must be based on the known facts at the date of distribution. Here, they assert, at the time of distribution, there was no way of knowing whether the contract would prove profitable. They point to an earlier tax court decision holding that for purposes of determining capital gain on distribution of this contract, the contract had no fair market value. 19 T.C.M. 1546 (1960).

In that decision the court had stated:

> "Petitioner, Henry A. Kuckenberg, who was the president of the corporation and the directing head of its business operations, testified at the hearing and gave as his opinion that the contract had no fair market value at the time it was assigned. The gist of his testimony was that at the time the contract was assigned no one knew or could know whether or not the contract would be profitable. He testified that the company expected to make a profit when it took a contract such as this one but that this expectation did not always turn out to be true, that sometimes in the experience of the corporation it had completed a contract at a loss."

Such uncertainty is not unusual. While fairly bearing on the question of capital gain we feel it is no basis for denying authority to the commissioner to change the corporation to a percentage of completion method where the cash method did not clearly reflect the income.

Upon the petition of the commissioner, the tax court is reversed.

Upon the petition of respondents, the tax court is affirmed.

(Endorsed) Opinion Filed Oct. 11, 1962.

FRANK H. SCHMID, Clerk.

JUDGMENT

Upon Petition to Review a Decision of The Tax Court of the United States.

This Cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the Decision of the said Tax Court of the United States in this Cause upon the petition of the Commissioner be, and hereby is reversed, and upon the petition of the transferees be and hereby is affirmed.